

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 93-0305
Indiana Corporation Income Tax
For The Tax Periods: 1988 through 1990

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ISSUES

I. **Indiana Gross Income Tax**: Wholesale Sales

Authority: IC 6-2.1-2-1(c); IC 6-2.1-2-3(a); *Jefferson Smurfit Corporation v. Indiana Department of State Revenue*, 681 N.E.2d. 806 (Ind. Tax 1997).

Taxpayer protests certain receipts taxed at the high rate rather than the low rate.

II. **Indiana Gross Income Tax**: Sale of Intangibles

Authority: IC 6-2.1-2-2; 45 IAC 1-1.1-6-2; 45 IAC 1.1-1-3; *Indiana Department of State Revenue v. Bethlehem Steel*, 639 N.E.2d. 264 (Ind. 1994).

Taxpayer protests the inclusion of sales of certain intangibles in calculating gross income.

III. **Negligence Penalty**: Imposition

Authority: 45 IAC 1-1-34.

Taxpayer protests the Department's imposition of negligence penalty.

STATEMENT OF FACTS

Taxpayer provides custom packaging services to manufacturers and other customers.

Additional facts will be provided when necessary.

I. **Indiana Gross Income Tax**: Wholesale Sales

DISCUSSION

Receipt of gross income from "wholesale sales" is subject to the low rate of tax prescribed in IC 6-2.1-2-3(a). Pursuant to IC 6-2.1-2-1(c)(1)(D), "wholesale sales" includes:

Receipts from industrial processing or servicing, including:

- (i) tire retreading; and
- (ii) the enameling and plating of tangible personal property which is owned and is to be sold by the person for whom the servicing or processing is done, either as a complete article or incorporated as a material, or as an integral or component part of tangible personal property produced for sale by such person in the business of manufacturing, assembling, constructing, refining, or processing.

Thus, receipts from industrial processing are subject to the lower gross income tax rate as “wholesale sales”. Taxpayer packages products that are resold as well as products that are not. The Department included receipts from products that are resold as “wholesale sales” subject to the lower rate of tax. In cases where the packaged products were not resold, the Department assessed gross income tax at the high rate of tax.

Taxpayer protests the Department’s taxation of these receipts at the high rate of tax. Citing *Jefferson Smurfit Corporation v. Indiana Department of State Revenue*, 681 N.E.2d. 806 (Ind. Tax Ct. 1997), taxpayer argues that these receipts should be taxed at the low rate.

Accordingly, the Department finds that *Jefferson Smurfit* is dispositive. Therefore, the receipts from packaging products that were not resold should be taxed at the low rate.

FINDING

Taxpayer’s protest is sustained.

II. Indiana Gross Income Tax: Sale of Intangibles

DISCUSSION

Taxpayer is an out-of-state corporation with its commercial domicile in another state. Taxpayer closed two Indiana plants and transferred customer lists, contact information, and customer specifications to its office in another state. Subsequently, the taxpayer negotiated a contract for the sale of customer lists, contact information, and customer specifications to an out-of-state purchaser. The transaction was negotiated and consummated outside Indiana. The Department included taxpayer’s receipts from this transaction in its determination of taxpayer’s taxable gross income.

Taxpayer protests the Department’s inclusion of these receipts in taxable gross income. The Department treated this transaction as receipts from the sale of intangibles with an Indiana tax situs. Thus, the receipts were included in gross income and subject to tax. Taxpayer argues that its receipts from the sale of customer lists, contact information and customer specifications are not subject to gross income tax because the intangibles lack Indiana tax situs.

Indiana imposes an income tax, known as the gross income tax, upon the receipt of “the taxable gross income derived from activities or businesses or any other sources within in Indiana by a taxpayer who is not a resident or a domiciliary of Indiana.” IC 6-2.1-2-2. In general, receipts derived from an intangible are included in gross income. 45 IAC 1.1-6-2. Intangible means a personal property right, which exists only in connection to something else. 45 IAC 1.1-6-2. Taxpayer’s sale of customer lists, contact information and customer specifications are considered a sale of intangibles for gross income tax purposes. Thus, these receipts should be included in gross income unless “the intangible does not form an *integral* part of a trade or business situated and regularly carried on at a *business situs* in Indiana, *and* the taxpayer’s commercial domicile is located outside Indiana.” 45 IAC 1.1-6-2(c)(2). Since taxpayer is commercially domiciled outside Indiana, to determine whether taxpayer’s sale of intangibles is subject to Indiana gross income the following issues must be resolved:

- (1) Taxpayer must have “business situs” in Indiana
- (2) The intangible must form an “integral” part of business carried on at taxpayer’s business situs in Indiana

Taxpayer has a business situs in Indiana. “Business situs” arises where possession and control of a property right have been localized in some business activity away from the owner’s domicile. 45 IAC 1.1-1-3. Taxpayer’s ownership of two Indiana plants where it conducted business activities and its ownership of income-producing property in Indiana are sufficient to establish a “business situs” in Indiana.

Therefore, the sole issue remaining to determine whether taxpayer’s sale of intangibles is taxable as part of Indiana gross income is whether the intangibles formed an “integral” part of business carried on at taxpayer’s business situs in Indiana. In determining whether an intangible forms an integral part of a trade or business or activities incident thereto, it is the connection of the intangible itself to such trade or business or activities incident thereto that is the controlling factor. 45 IAC 1.1-6-2(d).

Citing *Indiana Department of State Revenue v. Bethlehem Steel*, 639 N.E.2d. 264 (Ind. 1994), taxpayer argues that the intangibles (customer lists, contact information and customer specifications) sold by taxpayer are not integral because the connection is merely remote or incidental at best. In *Bethlehem Steel*, the Indiana Supreme Court held that a taxpayer’s income from its sale of tax benefits was not part of taxable gross income because the tax benefits were not “integrally related” to a business situs within Indiana and thus were not derived from sources within Indiana. The Court stated that whether a nondomiciliary’s gross income from an intangible derives from an Indiana “source” depends on the relationship between the actors, activities, and property creating the income. Furthermore, the Court stated that Indiana may not tax nondomiciliaries where the relation between Indiana and the subject of the tax is merely remote or incidental to the interstate transaction. *Bethlehem Steel*, 639 N.E.2d. 264, at 270 (citing *Indiana Department of State Revenue v. J.C. Penney*, 412 N.E.2d. 1246 (Ind. App. 1980)). The Indiana connection must be at least “more than minimal.” *Bethlehem Steel*, 639 N.E.2d. 264, at 270 (citing *Indiana Department of State Revenue v. Convenient Industries of America*, 299 N.E.2d. 641 (Ind. App. 1973)). Taxpayer argues that the intangibles it sold were merely incidental to its business in Indiana. Moreover, taxpayer contends that the intangibles were

moved to an out-of-state location after the Indiana plants were closed. Citing *Bethlehem Steel*, taxpayer supports its contention that its sale of intangibles was not integrally related to business activities in Indiana for the following reasons:

- (1) the decision to sell the intangibles was made outside of Indiana
- (2) the sale was negotiated and consummated outside Indiana
- (3) the in state management had nothing to do with the sale
- (4) the proceeds were transferred to taxpayer outside Indiana; and
- (5) the closing of the Indiana plants was not affected by the decision to sell the intangibles.

Taxpayer argues that these out-of-state factors outweigh any remote or incidental connection to its Indiana business activities. In *Bethlehem Steel*, both the buyer and seller were non-Indiana corporations with non-Indiana commercial domiciles; the decisions to enter these agreements were made out of state, not by in state management; and the sales themselves were negotiated and completed out of state. *Bethlehem Steel*, 639 N.E.2d. 264, at 271. Taxpayer argues that because its transaction for the sale of intangibles was transacted in the same manner as the transaction in *Bethlehem Steel*, its receipts cannot be considered derived from Indiana sources.

However, the Court in *Bethlehem Steel* suggested the out-of-state factors be weighed against the in-state factors to determine Indiana “tax situs.” *Bethlehem Steel*, 639 N.E.2d. 264, at 270. In this case, taxpayer did not sell tax benefits unrelated to its business situs in Indiana. Rather, taxpayer sold customer lists, contact information and customer specifications, all of which were connected to its business activities within Indiana. These intangibles are hardly remote or incidental to taxpayer’s business in Indiana. The controlling factor to determine whether intangibles are an “integral” part of a taxpayer’s Indiana business or activities is “the connection of the *intangible itself*” to such business or activities. 45 IAC 1.1-6-2(d). Notwithstanding the out-of-state factors surrounding the transaction, the connection of the customer lists, specs, and contacts to taxpayer’s business and activities in Indiana were certainly “more than minimal.” Customer lists, contact information and customer specifications were an integral part of taxpayer’s business in Indiana. Although the intangibles were moved to a location out of state, the location of the evidence of the intangible is *not* a controlling factor. 45 IAC 1.1-6-2(d). Moreover, the intangibles were sufficiently connected to taxpayer’s business and activities in Indiana.

Thus, the Department finds that taxpayer’s sale of intangibles were integrally related to its activities and business in Indiana. Therefore, the receipts from the sale of intangibles are part of taxpayer’s taxable gross income in Indiana.

FINDING

Taxpayer’s protest is denied.

III. Negligence Penalty: Imposition

DISCUSSION

Indiana Code 6-8.1-10-2.1(d) allows a penalty to be waived upon a showing that the failure to pay the deficiency was due to reasonable cause. Pursuant to 45 IAC 15-11-2(c), in order to establish reasonable cause, taxpayer must show that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty, giving rise to the penalty imposed. The Department finds that the taxpayer acted reasonably and exercised ordinary business care and prudence.

FINDING

Taxpayer's protest is sustained.